

BOOK REVIEWS

CENTRAL BANKING TEXTBOOK

Luboš Komárek, Czech National Bank

Zbyněk Revenda. Centrální bankovníctví

Prague : Management Press, 2011, 3rd Edition. 560 s. ISBN 978–80–7261–230–7.

This is the third edition of the textbook “Centrální bankovníctví (*Central Banking*)”, written by Zbyněk Revenda, which is a standard and established undergraduate publication on the Czech market. The author is a lecturer at the Faculty of Finance and Accounting at the University of Economics in Prague. He is a well known author of several textbooks dealing mainly with banking, finance, monetary theory and policy.

The textbook under review is divided into six relatively distinct sections. **The first section** plays an introductory role to the subsequent five sections. It is oriented to the explanation of basic terms from the area of central banking. The author focuses on, *inter alia*, the definition of the banking system and its variants, historical overviews of the development of central banking, the main accounting statements of commercial banks (such as financial balance, profit and loss statement) and the balance of the central bank. This chapter also explains the main activities of central banks, which are elaborated in the sections which follow.

The second section concentrates on the description of the main activities and functions for which the central bank is responsible, *i.e.* (i) issuing of money, (ii) conduct of monetary

policy, (iii) exchange activities including the areas of foreign exchange reserves and regulation, (iii) regulation and supervision of commercial banks, (iv) functioning as the bank of banks and (v) functioning as the bank of the government. The understanding contained within these chapters is a precondition for understanding the role of the central bank in the market economy. In this context it seems that a concluding chapter, which would comment on the varying responsibilities and mandates among central banks in the world, would be desirable. Some central banks are responsible for all the above-mentioned activities and functions (such for example the Czech National Bank), but many central banks are not. On the national level for example there is the role of the central bank as the single regulator of the financial market. This organizational model is applied for example in the Czech Republic, Slovakia, Lithuania and other few countries in the world. Nevertheless, significant group of central banks are not responsible for banking regulation and supervision, for example Hungary, Poland and Sweden. On the supranational level many central banks of European countries have had to hand over the conduct of monetary policy (and will probably do the same with bank regulation and supervision in the current process of the creation

of the so-called banking union) to the European Central Bank.

The third section is focused on the monetary policy of the central bank. The author initially explains crucial principles from central banking, *i.e.* the creation of noncash payments and multiplication of bank deposits through commercial banks. Then the focus is oriented to the explanation of different channels of transmission mechanism, which are essential for the effective conducting of monetary policy. The author discusses at length two transmission channels in separate chapters: monetary and credit. The others channels are from the reviewer's point of view rather unnecessarily clustered in only one chapter, which has a slightly misguided structure so that issues such as inflation targeting, exchange rate channel or production gap are lumped together. The part about inflation targeting should be included in a new broader chapter, oriented to the evaluation of monetary policy regimes, as for example is regularly done by the International Monetary Fund. (The Czech National Bank – together with other more than 30 central banks – is applying the inflation targeting regime from the January 1998.) Furthermore separate chapters should be devoted to the exchange rate channel and the exchange rate path, not only because of the importance of these to the Czech economy but because of their importance to the small open economy in general. From the reviewer's point of view some chapters of the book overlap with standard macroeconomic books, for example the chapter devoted to inflation or the explanation of the IS-LM model, *i.e.* the basic Keynesian macroeconomic model.

In the fourth section the author discusses the main reasons underlying the regulation and supervision of commercial banks, *i.e.* limited conditions of entry into the industry, measures to reduce the risk and information asymmetry in banking, deposit insurance and the operation of the central bank as lender of last resort. This section also includes a chapter focusing on the problem of the regulation of commercial banks

which operate internationally or globally. This chapter opens the door to a very relevant problem, *i.e.* how to supervise and regulate big financial institutions, which includes banks, pension funds, insurance companies, *etc.* An evaluation of financial stability and the discussion of the macroprudential mandate of central banks would be beneficial in the next edition. Central banks have been publishing financial stability reports mainly since the beginning of new millennium; the macroprudential mandate is starting to be anchored in the law of central banking.

The fifth section introduces central banking development in the Czech Republic, and also in the European Union and other countries which play leading roles in central banking, such as the United States, Canada, Japan, Switzerland or China. The author has appropriately chosen those central banks which are more dominant. Their currencies play (or will probably play, in the case of The People's Bank of China) the role of reserve currencies; their actions create positive or negative externalities for other central banks in developed and developing countries.

In the final **sixth section**, the author summarizes the main variants of possible development of banking systems, which include monetary union, currency boards, dollarization of the economy and free banking. Finally, the author discusses the near future of central banking, which is a good starting point for the motivated reader to study more advanced texts and issues, mainly in respected academic journals which deal with these problems.

From the reviewer's point of view, working for many years for both the central bank and academia, some topics, or at least notes, on the problems which are confronting central banks in the new millennium, are omitted. The explanation of at least three main areas is absent. The first is the relationship between monetary policy, fiscal policy and especially the newly anchored prudential policy on both microprudential and macroprudential levels. The second is the issue of unconventional monetary policy, *i.e.* in simple

terms the situation when central banks reach the zero low bound for monetary policy rates. This situation has been facing Japan for many years, currently also for example the Czech Republic, and especially two of the most important central banks – The Federal Reserve and the European Central Bank – since the late stage of current financial crisis. The third is more theoretically oriented. This reviewer is missing the description of a crucial phenomenon in dealing with central banking, which is the aggressiveness of central banks, including the problems of time inconsistency of monetary policy, price level indeterminacy (Sargent and Wallace: “Rational” Expectations, the Optimal Monetary Instrument, and the Optimal Money Supply Rule. *The Journal of Political Economy*, 1975, No. 2.), and the so-called Taylor principle (J. B. Taylor: *Discretion versus Policy Rules in Practice*. Carnegie-Rochester Conference Series on Public Policy 39, 1993). While the description of the banking system in a socialistic economy might be briefly summarized, more than twenty years of the market economy in the Czech Republic has made this problem less than topical.

This textbook has several advantages in the reviewer’s eyes, *i.e.*: (i) deep explanation of many of the fundamental problems of central banking which are necessary for understanding the difficulties which central banks face; (ii) the use of very intuitive diagrams, which could be very useful as an aid to understanding and a quick review of particular topics; (iii) the integration in

the main text of definitions of important terms. A bibliography and index is naturally included in this textbook, which also helps readers to find particular problems or issues. The text of this publication is suitably supplemented by a number of tables, charts and graphs that contribute to clarity of interpretation of many issues and phenomena. The reviewer also appreciated that the author does not come up with specific recommendations and avoids normative judgments.

Revenda’s “Central Banking” provides readers with a comprehensive view of the functioning of central banks. It is overall a well established publication, which has been used in many undergraduate courses across economics faculties in the Czech Republic for more than 10 years. This textbook is a good source of basic knowledge in the area of central banking for a broad readership. It provides a good introduction to the understanding of the position of central banks in the market economy and several problems which face central banks. It can serve as a basic and supplementary textbook in master’s degree courses in particular, and for all those interested in the study of macroeconomics, the national economy and finance. The knowledge included in this textbook is a good base for subsequent processes of learning in the field of central banking which utilise more advanced books and articles from academic journals.

(Note: This review represents the author’s own views and does not necessarily reflex those of the Czech National Bank.)